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TAX & EXCHANGE CONTROL ALERT

IN THIS ISSUE

Substance over form: A UK judgment about the avoidance of capital gains tax

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Customs & Excise Highlights

This week's selected highlights in the Customs & Excise environment since our last instalment.

Substance over form: A UK judgment about the avoidance of capital gains tax

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In the United Kingdom, capital gains tax (CGT) under the Taxation of Chargeable Gains Act, 1992 (TCGA) is charged, *inter alia*, where a taxpayer disposes of an asset for an amount greater than the base cost at which such taxpayer initially purchased the asset.

The TCGA contains several types of anti-avoidance provisions where a transaction is not conducted on an arm's length basis, including rules that deem such a disposal to be at market value and set a time of disposal where connected parties seek to arrange their affairs to defer a CGT liability.

In Trustees of the Morrison 2002 Maintenance Trust and Others v Revenue and Customs Commissioners [2019] EWCA Civ, the Court of Appeal, Civil Division, had to decide whether the taxpayers were liable for CGT, where they disposed of shares in a manner that was perceived to be done with the intention of avoiding a CGT liability.

Facts

Over the period 1989 to 2002, Sir Morrison set up a series of trusts (Scottish Trusts) and appointed Scottish trustees (Scottish Trustees). The Scottish Trustees wished to divest from AWG plc (AWG) but had reservations about triggering CGT. Therefore a scheme was embarked on consisting of the following:

- (i) The establishment of trusts with Irish-resident trustees (Irish Trustees) and terms similar to those of the Scottish Trusts;

- (ii) The grant by the Irish Trustees to the Scottish Trustees of put options for the sale of the AWG shares at a price equal to the Scottish Trustees' CGT base cost plus indexation (if any). This put option was made subject to a "Relevant Event" being a certain exchange rate between the Pound and US Dollar;
- (iii) Following the occurrence of the Relevant Event, the Scottish Trustees exercised the put options, resulting in the acquisition of the AWG shares by the Irish trustees for approximately £4 million;
- (iv) This was followed by the sale of the AWG shares by the Irish Trustees on risk sale basis to a third party, being approximately £14 million;
- (v) The shares were then sold on the open market by the third party who had in essence underwritten a certain price for the Irish Trustees, subject to an adjustment upwards depending on the price obtained in the market; and
- (vi) The replacement of the Irish Trustees by trustees resident in the United Kingdom before the end of the tax year.

The combined effect of the put option and later sale was to trigger s144ZA of the TCGA, which would have the effect of fixing the base cost for the AWG shares at the price they were sold to the Irish Trustees and therefore insulating the transaction from CGT.

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The key principle laid down in Ramsay was that where a transaction or series of transactions is intentionally designed with an element which serves no commercial purpose and only provides a tax benefit, a court will take cognisance of the substance over the form.

Her Majesty's Revenue and Customs (HMRC) assessed the Scottish Trustees for the full market value of the sale of the shares in AWG as received by the Irish Trustees, on the basis that the transaction ought not to benefit from s144ZA on the basis of the principles laid down in *W T Ramsay Ltd v IRC, Eilbeck (Inspector of Taxes) v Rawling* [1981] STC 174, [1982] AC 300 (Ramsay).

Key Issues

A number of years before the case discussed in this article was decided, a decision was handed down in Ramsay where a general interpretative anti-avoidance mechanism was established. The principles in Ramsay were established in addition to the statutory anti-avoidance provisions contained in the TCGA.

As explained by the Court of Appeal in the matter under discussion, the key principle laid down in Ramsay was that where a transaction or series of transactions is intentionally designed with an element which serves no commercial purpose and only provides a tax benefit, a court will take cognisance of the substance over the form. If the substance of the series of transactions falls within the ambit of the purpose of a legislative provision then this ought to be applied without blinkered recourse to the literal interpretation of the provision, which would allow the artificially created tax benefit.

The main consideration in the matter under discussion was whether the variable events interposed in the series of transactions sufficient to introduce the uncertainty necessary to remove the transaction from the realm of a pre-ordained series of transactions or a composite transaction. If that were the case, the principles laid down in Ramsay would not be applicable.

As the creation of the Irish trusts and transfer of the shares served no commercial purpose, the above turned on whether the chain of events constituted a pre-ordained series of events. This required a consideration of whether the suspensive conditions introduced by the Relevant Event and risk sale introduced sufficient uncertainty in the series of events so as to render the actual outcome not pre-ordained or the transactions not part of a composite whole.

Decisions of the First Tier Tribunal & Upper Tribunal

Both tribunals found that the Ramsay approach was applicable and based on a proper construction of the factual matrix surrounding the transactions they should be viewed as a composite whole. The composite whole being the disposal of the AWG shares by the Scottish Trustees at market value.

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The Court of Appeal in considering the facts confirmed that the Irish trusts were set up solely as an avoidance vehicle and had no independent commercial purpose.

The Upper Tribunal confirmed that the First Tier Tribunal was correct in holding that there was no practical likelihood that:

- the Irish Trustees would not sell the AWG shares to the market at market value;
- the involvement of the third party made no material difference; and
- it was correct to consider the position as at the point in time where the option was exercised, rather than when the option was granted.

Decision of the Court of Appeal

The Scottish Trustees in the Court of Appeal disputed at which point in time the Ramsay principles ought to be applied. They contended that the appropriate time to determine whether a pre-ordained transaction was in place was when the option was extended by the Irish Trustees. Their argument was based on the fact that at this point the decision by the Scottish Trustees to sell and the Irish Trustees to on-sell had not yet been made and therefore there could not be a pre-ordained series of transactions that would fall within the Ramsay principles.

Secondly, the Scottish Trustees argued that if the appropriate time to assess the applicability of the Ramsay principles was at the exercising of the option, the necessary practical arrangements for the

series of transactions to flow were not in place. In other words, there was no certain buyer or certain price for the potential sale. This argument was based on *Shepherd (Inspector of Taxes) v Lyntress Ltd, News International plc v Shepherd (Inspector of Taxes)* [1989] STC 617, 62 TC 495, where it was held that where it is not certain that a disposal will take place or the details thereof envisioned the Ramsay principles cannot find application.

The Court of Appeal in considering the facts confirmed that the Irish trusts were set up solely as an avoidance vehicle and had no independent commercial purpose. Further, it held that while the Irish Trustees were independent, the likelihood that they would conduct themselves contrary to the wishes of the Scottish Trustees or settlor was negligibly remote. Lastly, it held that the appropriate time to consider the transaction was where the option was exercised by the Scottish Trustees, rather than when the option was extended.

The Court of Appeal found that the principles laid down in Ramsay were applicable in this matter, confirmed the Upper Tribunal's decision and held that the transaction as constructed by the Scottish Trustees was in reality a sale of the AWG shares at the market value they were in fact sold by the Irish Trustees, rendering CGT payable on the extent of the chargeable gain.

Substance over form: A UK judgment about the avoidance of capital gains tax...*continued*

From a practical perspective, South African taxpayers should ensure that when doing tax planning, a transaction that is done for purposes of tax efficiency must also have a proper commercial basis.

Conclusion

The judgment serves as an interesting example of how the substance over form doctrine has been applied by the courts of a foreign jurisdiction. From a South African perspective, taxpayers should note that South African courts have also been asked to apply the substance over form doctrine, most recently in the Sasol Oil decision, which was handed down by the Supreme Court of Appeal towards the end of 2018. In addition to the substance over form doctrine, South African tax legislation also contains the general anti-avoidance rules (GAAR), which are contained in s80A to s80L of the Income Tax Act, No 58 of 1962.

From a practical perspective, South African taxpayers should ensure that when doing tax planning, a transaction that is done for purposes of tax efficiency must also have a proper commercial basis. Where a transaction has been concluded without a proper commercial basis, there is a risk that the South African Revenue Service can conduct an investigation into a taxpayer's affairs and apply the substance over form doctrine or the GAAR to a particular transaction. In such an event, a taxpayer could become liable for additional tax, interest and penalties.

*Tsangadzaome Mukumba and
Louis Botha*

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Customs & Excise Highlights

In the event that specific advice is required, kindly contact our Customs and Excise specialist, Director, Petr Erasmus.

This week's selected highlights in the Customs & Excise environment since our last instalment.

1. Carbon Tax

The Carbon Tax Act, No 15 of 2019 has been promulgated. Its objective is to provide for the imposition of a tax on the carbon dioxide (CO₂) equivalent of greenhouse gas emissions and to provide for matters connected therewith. The commencement date is 1 June 2019.

The Customs and Excise Amendment Act, No 13 of 2019 has been promulgated. Its objective is to amend the Customs & Excise Act, No 91 of 1964 (Act) so as to make provision for the administration and collection of carbon tax revenues and to provide for matters connected therewith. The commencement date is also 1 June 2019.

Comments in relation to draft amendments to the Schedules and Rules to the Act pertaining to carbon emissions tax (as dealt with in our [Tax and Exchange Control Alert of 10 May 2019](#)) has been extended to 14 June 2019. Further, form DA180 and annexures have now been added to the draft rule amendment and related forms, as follows (certain sections quoted from the SARS website):

- Completion notes to form DA180 and annexures;
- DA180 – Environmental Levy Return for Carbon Tax;
- DA180.01A.1 – Fuel combustion stationary source;
- DA180.01A.2 – Fuel combustion non-stationary source;
- DA 180.01B – Fugitive emission source;
- DA 180.01C – Industrial process source;

- DA 180.02A.1 – Fuel combustion stationary: Allowances;
- DA 180.02A.2 – Fuel combustion non-stationary source: Allowances;
- DA 180.02B – Fugitive emission source: Allowances; and
- DA 180.02C – Industrial process source: Allowances.

As communicated previously by SARS, this account only needs to be submitted in July 2020.

- ### 2. Amendments to Rules to the Act (certain sections quoted from the SARS website):

Draft rules under s8 of the Act, relating to the reporting of conveyances and goods (RCG) for trains, and intended to replace the current rules under s8 of that Act were published for public comment.

The content of the proposed rules under s8 is closely related to Chapter 3 of the Customs Control Act, No 31 of 2014. The proposed rules are intended to bring the RCG requirements under the Act closer to what will be required in terms of the Customs Control Act when that Act comes into effect.

Due date for comments is 14 June 2019 and may be sent to C&E_legislativecomments@sars.gov.za.

- ### 3. We have dealt with the SARS rewrite of the excise legislation in our [Tax and Exchange Control Alert of 29 March 2019](#). The due date for comments has been extended to 14 June 2019 for the attention of Ms Samantha Authar, either electronically to C&E_legislativecomments@sars.gov.za, or manually to the South African Revenue Service, Private Bag X923, Pretoria, 0001.

Customs & Excise Highlights...continued

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4. The South African Association of Freight Forwarders (SAAFF) has over an extended period requested SARS to publish tariff determinations made by SARS. SARS issued a communication to SAAFF dated 20 May 2019 wherein SARS advised that the request has been considered favourably and will be put forward for the Minister's consideration as part of the 2020 Budget announcement.
5. The Department of Agriculture, Forestry and Fisheries published a notice in the Government Gazette on 17 May 2019 wherein its intention is made known to amend Prohibition Notice No. 570 dated 27 May 2016 regarding the removal of imported regulated agricultural products intended for sale in the Republic of South Africa from the prescribed ports of entry.

All interested parties are invited to submit comments and any representations concerning the proposed amendment in writing within 30 days from the date of the Notice to the following addresses:

Executive Officer: Agricultural Product Standards

Department of Agriculture, Forestry and Fisheries

Private Bag X343, Pretoria, 0001

30 Hamilton Street, Harvest House Building, Arcadia, Room 147

Tel. no.: (012) 319 6051;

Fax no.: (012) 319 6265;

Email: MadibaW@daff.gov.za.

6. The Department of Health published a notice in the Government Gazette on 23 May 2019 wherein certain preparations containing Cannabidiol (CBD) are excluded from operation of certain provisions of the Medicines and Related Substances Act, No 101 of 1965.

Petr Erasmus

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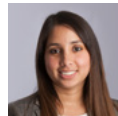
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